THE JOURNAL

OF

POLITICAL ECONOMY

VOLUME 24 February 1916 NUMBER 2

WAR FINANCE AND AMERICAN BUSINESS[1]

It is no part of my task to analyze the long-time effects of the impoverishment of Europe upon our place and interest in international trade. It cannot be good for us to have our best markets closed or our best customers crippled—those peoples who, by buying from us, must sell to us—nor can we profit by the paralysis of their productive power, and the resulting cancellation of their purchasing power. It is, in fact, their purchasing power—in other words, their productive power—which creates for us our opportunity of selling—the possibility of selling to them, together with all the advantages of this selling. We need markets for our surplus product, it is true, but only in the sense of needing, not a chance of merely getting rid of these products, but of getting something for them. In the long run, there is no purpose in exports but that of return imports. Refusing the imports, or failing to be offered them, we should as well drop our exports into the sea, a mile or two out, and save the expense of the longer voyage. Nor, even if we could continue to bring back money as our sole *quid pro quo* for our exported goods, would this be worth while excepting as the money were our title to a later exportation of the money for purposes of purchase. To nations, as to individuals, money is good only for

[1] The substance of an address delivered, without manuscript, at the meeting of the Western Economic Association, in Chicago, November 27, 1915. In some respects the data presented have been extended to cover the succeeding weeks.

the things that it will buy. But for nations the interval between the time of getting the money and the time of sending it back abroad as purchasing power in foreign markets is, as I am about to emphasize, a period of danger.

Nor is it directly any part of my present duty to analyze the long-time world or domestic significance of the enormous public debts which are piling up in Europe, but only the proximate effects in America of the manner and volume of the creation of these debts. That the preparedness of France a year and a half ago was summed up in $6\frac{1}{2}$ billion dollars of national debt and no shoes does, doubtless, greatly resemble our own present achievements in preparedness of both army and navy but is nothing to the purpose of this article. Or that France, even if victorious and free of indemnities, is likely to emerge from the present struggle with a total debt of from 15 to 20 billions of dollars for its 40 millions of people—an annual interest-charge greater than the current national expenses of the United States with its 100 millions of population—and under the additional burden of those current expenses of government which have for decades imposed a fiscal deficit and increased borrowing—all this might mean little to us in America, were we ourselves not certain to become involved in those processes by which the new and staggering increase of debt must be created.

Nor does our interest in the problem center merely upon the question whether the securities which France is so rapidly issuing are a safe investment—whether France will be able to stagger forward under interest-burdens of $75 to $100 per family over and above her $30 to $40 of annual outlay in current national budgets. We may note, however, that a billion dollars of interest-charges means for France that something like one-seventh of her population is to be supported as a *rentier* class at the charge of the remaining tax-burdened six-sevenths. France must some day face a choice of drastic income taxes, single-tax confiscations, and inheritance escheats, as against either revolution or repudiation. France is not likely to choose either the revolution or the repudiation. New taxes approaching perilously near to indirect repudiation must be devised. But the enormous non-interest-bearing debt which France, like all the other warring powers, continues to inject

into its currency circulation appears likely to go unredeemed. And perhaps it will be better so, else the present period of rising prices will be followed by the greater misfortunes of a period of contracting currency and falling prices.[1]

Nor is it to the present purpose to discuss the menace of that stimulated immigration to America which appears likely to be the long-time effect of the prospective increase of taxation. My business is solely with the direct effect upon us of the enormous issues of war obligations, in view, particularly, of the manner of their creation. In the main, also, I shall confine my analysis to the English situation. The methods of French finance are, in most respects and essentially, those of England,[2] also. The methods of Germany, which are not greatly different, concern us only slightly—by the very fact that Germany's commercial isolation excludes her from both our commodity and our financial markets.

The annual costs of England's war activities have now reached a total of something like half the annual productive power of England. Out of approximately 18 millions of breadwinners, 3 to

[1] "The following table shows how the Treasury has constantly been able to keep up to the requirements of the first fifteen months of the war:

Extraordinary treasury resources realized from August 1, 1914, to October 31, 1915:

	Francs
Advances of the Bank of France	7,000,000,000
Advances of the Bank of Algeria	75,000,000
National Defense obligations:	
Subscriptions in cash	2,388,178,000
Subscriptions by means of bonds unexpired	345,620,000
National Defense bonds:	
Net product of issue	8,319,588,000
3½ per cent redeemable loan	462,263,000
Bonds abroad: England, 1,028,976,000, United States, 135,716,000	1,164,692,000
Anglo-French loan in United States	1,250,000,000
Total	21,005,341,000

The State could still ask of the Bank of France 1,700,000,000, and of the Bank of Algeria 25,000,000, if it desired to avail itself of the power of drawing conferred by the law. . . . . The Financial Minister was quite right in saying that the Treasury was as ample in resources now as at any time since the commencement of this long war."—*Commerce and Finance*, December 15, 1915.

Since the outbreak of the war the circulating notes of the Bank of France have increased by nearly a billion and half of dollars.

[2] Premier Viviani boasted two months ago, before the National Assembly, that, up to that date, France had financed the war without a dollar of new taxes, and without burden of any sort to the people of France.

4 millions are upon the firing line or in the training camps. For productive purposes, these men are retired, withdrawn. They count for the purpose as if they did not exist. For other purposes, however, they count for something more. Each man in active service requires food, clothing, shelter, and attendance, on especially expensive terms. At a reasonable estimate, the upkeep of each soldier absorbs the product of one worker, either in England or abroad. Still another worker, English or other, is necessary to furnish the ammunition, the war craft, and the transportation facilities. It is, therefore, intelligible that, while the statistical authorities in England place the annual income of England at 12 billions of dollars, the reports of the government are indicating a rate of war expenditure of upward of 6 billions. Or the same facts may be put in another way: each English soldier is estimated to cost about \$5 per day—\$1,800 per year. At this rate, an army of $3\frac{1}{3}$ millions imposes an annual cost of 6 billions of dollars.

Were England, therefore, disposed to do, and able to do, what Germany is practically compelled to do—namely, to solve the problem of waging war solely by appeal to domestic productive power—England's fiscal policy would sum up into the attempt to intercept for government purposes one-half of the income accruing to the English people—to substitute government spending for individual spending to the extent of one-half of the total productive power of the country, to put the producing and income-receiving public on half-allowance and half-rations, in order to allot to military needs the other half of the available current resources of the country.

Allowing time for the necessary readjustments, the domestic financing of England's share in the war might not present an economic impossibility, although it would probably present a political impossibility. The industrial masses of England are not trained to saving—are not the capitalizing classes in England. Government borrowing can make small appeal to them, and domestic taxation to the degree which would be necessary would be impracticable under conditions of popular government. Only an autocratic government under a collectivist organization of industry could be adequate to the task of commandeering for government

purposes half of the productive power and of the consumption rights of any people—even of a people with the enormous available surplus above the strict necessities of life which the English people enjoy. Under actual conditions the resources of the English government are practically limited to devices of taxation and public borrowing. Neither method alone, nor both together, can solve the problem of turning over to the government one-half of the purchasing power of the nation for redistribution into war activities or the support of war activities. Thus, the increase of the tax revenues of England for this second year's war are expected to provide for only about three-fourths of a billion of revenue. Borrowing, either at home or abroad, must provide $5\frac{1}{4}$ billions.

The English statisticians compute the current saving of England in ordinary years at about $1\frac{3}{4}$ billions. The compulsion of higher taxation and the domestic marketing of government securities, it is held, may suffice to double the domestic contribution to government expenditure.

The utmost, then, that appears possible in the way of diverting England's production to the support of war expenditures will run to $3\frac{1}{2}$ billions. America is practically the sole market in which the further necessary funds can be had, or the residue of the necessary supplies procured. True, the exportation of products from England must, as usual, apply toward the payment of English imports; but there is still this balance of $2\frac{1}{2}$ billions which must be otherwise covered.[1]

It is evident, then, that for the purchase of these foreign supplies no virtue can attach to the domestic issue of government money, either direct or indirect. Purchasing power in the American market must be created by the export of goods or of gold, or of securities, by transportation services, or by the placing of English government loans. Only for domestic purposes can any debasement

[1] In a statement prepared for the Associated Press, December 14, Sir George Paish, editor of the *Statist*, said that the favorable balance of foreign trade of the United States next year is likely to mount up to $2\frac{1}{2}$ billion dollars, and after due allowance for all possible offsets, foreign countries will owe the United States about 2 billion dollars on the year's business, which must be paid either in gold, or by the return of American securities owned abroad, or by credits extended to foreigners by American bankers.

of coinage, or forced loans, or inflations of credit currency avail to place the government in control of its increased volume of purchasing power. Whatever supplies the forces of domestic production will not afford must be derived from exterior sources, on terms acceptable to the sellers. And, unless under collectivist methods, the government must possess itself of media of exchange, if it is to obtain commodities or services either at home or abroad. Taxation and the issue of government securities and the resort to forced loans are purely domestic devices. Sales of things abroad or borrowings of funds abroad are the only methods of getting supplies from abroad. England's actual problem is, then, to provide in America purchasing power with which to command the necessary supplies of American goods—purchasing power of approximately $2\frac{1}{2}$ billions of dollars.

But during the first year of the war England made substantially no appeal to the increase of taxation at home or to borrowing abroad. About 300 millions of gold were sent to America.[1] "Since the outbreak of the war, sales of American securities to New York are estimated to have amounted to between 100 and 125 millions."[2] Three billions of funds England obtained mostly through domestic borrowing—in part under the form of government paper money known as treasury notes, but mainly through the issue of short-time treasury bills and various forms and denominations of bonds. Of these 3 billions of bond issues, however, not all were placed with the ultimate investor. A total of something like one billion was absorbed by the banks on terms of the issue of deposit credit by the banks. It is in this sort of finance that there lies the great and imminent danger to which I ask your attention.

Little, probably, need be said in condemnation of war finance or of any other state finance which relies upon the issue of paper

[1] In the interview previously cited, Sir George Paish said that the balance due on the 1915 foreign trade was 1,350 million dollars, of which 400 million has been settled in gold, 460 million by the recent Franco-British loan, "which American bankers and investors so generously provided for a short time ago," and about 500 million by the return of securities.

[2] *Bulletin of National City Bank*, December, 1915.

money in any form. Economic authority is practically unanimous in disapproval of the *cours forcé* or of any sort of circulating government credit. At the best, and inevitably, there follow disturbances of general prices.

Not so well accepted, however, but equally clear, are the ill effects of any sort of government borrowing, the practical effect of which is currency inflation. It is, in fact, precisely with this aspect of European war finance, and especially with the English phase of it, that the present analysis is concerned—not merely with the results in England, where the methods of borrowing have been of this inflation sort, but also with the results in America, where these methods are now in their earlier stages.

It is a commonplace that the use of money as banking reserves in support of issues of deposit credit multiplies several fold the efficiency of that money as a medium of exchange. If I lend you $1,000 in money, no change takes place in the volume of circulating medium. I have merely transferred to you the purchasing power at my disposal. As much as your purchasing power is increased, so much is mine diminished. And precisely so with my assignment to you of my deposit credit at the bank. I get your property or your note; you become in my stead the owner of the demand right against the bank. Thus far, then, our proceedings are neutral in their bearing upon the volume of currency in existence or in circulation.

Not so, however, if your supply of current funds is derived, not from a trade with me, but through the loan or discount processes of the banks. Opening business with cash resources of $100,000, and crediting a group of borrowers with $100,000 of deposits on its books, a bank will stand with 100 per cent of reserves against the demand liabilities. Discounting $200,000 of paper, its reserves are 50 per cent. Only with loans and with derivative deposits running at $625,666 do its reserves reach the ratio of 16 per cent; and if, in addition, it receives from outside sources deposits of $100,000 in cash, it becomes able to increase its accommodations to borrowers by an additional $525,000, still maintaining its reserves at 16 per cent. These deposit credits function as media of exchange. Bank lending expands the circulating medium; it creates currency.

It is therefore evident that when English bonds are placed with ultimate investors, who pay for them in cash or by assigning to the government deposit credits, no currency expansion takes place. If, however, the bonds are placed with banking institutions that pay for these bonds through the creation of deposit credit in favor of the government, these deposit credits amount to a net increase in the circulating medium of the country. The necessity of the maintenance of reserves stands as the only limit upon this process of currency inflation. But in point of fact no limit of this sort now exists. In September of 1914, an act of Parliament gave authority to the English cabinet to waive the legal restrictions upon the issues of the Bank of England. Thus, while it is true that no increased issues have yet been made, the privilege exists. The bank may, at any time, by this device, protect itself against pressure upon its reserves. Thus its discount activities are without limit. Protected by its power of issue, it is discounting with extraordinary liberality in aid of the city banks. Its new deposit liabilities, interchangeably with its notes, are reserves for these subordinate banks.[1]

It is, doubtless, true that a resulting advance in general prices should ordinarily, in due time, set in operation forces to deplete the ultimate gold reserves of the Bank of England; but in point

[1] "The service of the modern credit organization enables great payments to be made within a short time while spreading reimbursements over a very long time, and this allows of loan subscriptions without forcing the sale of property. If the citizen had to sacrifice his property by sale in order to buy government bonds, he might not do it, but if he can use his credit to buy a government bond and the interest on the bond will carry his own indebtedness, and the government can in turn use the bank credit for its disbursements, the process of financing a war is reduced to its easiest terms. . . . .

"Extreme ease continues to characterize the money market. . . . .

"It is probable that when these European countries are through floating war loans their banks will not be in very liquid conditions, but in each country the government is behind the situation, and the banks are provided with currency to meet any needs."—*Bulletin of the National City Bank*, November, 1915.

"The speed with which hybrid investments and assets located in every quarter of the globe have been converted into money has been an economic revelation. Loans to allies aggregating double the amount ordinarily invested abroad, made by a nation which is spending £5,000,000 a day in destructive warfare and rolling up an annual deficit of £400,000,000 in foreign trade, stagger the imagination."—*Commerce and Finance*, December 1, 1915.

of fact, specie redemption is suspended in England. The subordinate banks discharge their liabilities in Bank of England notes or in deposit credit with the Bank of England. The Bank of England releases gold, not on demand, but at its pleasure and discretion.[1] It is through this mechanism that the borrowing by the English government from the English banks has resulted in an increase of something like one billion dollars in the circulating medium of England—a billion dollars of currency expansion.[2] Thus, as a matter of government policy, and supported by a liberal lending policy on the part of the Bank of England, all sorts of collateral have been readily accepted by the subordinate banks as security for accommodations liberally granted.[3]

[1] It must be admitted that the gold convertibility of the money circulation of England is still quite generally asserted; as, for example, in the December 10, 1915, number of the *Investment News:* "While Great Britain and France have never abandoned the gold basis, Germany has."

The case is, however, quite fully covered by the sole fact that sterling exchange in New York has run, during recent months, at from 15 cents to 36 cents discount in the pound. This, it is true, does not necessarily mean that whatever gold circulates in England circulates at a premium over bank bills and deposit credit, but merely that a bill presented in London will not be paid in the form of gold available for export, but only in London funds available for the purchase of commodities which bear prices 40 per cent higher than prices of a year and a half ago—prices also at which the buyer who should export the goods to America would obtain in America a return so low that he would as well have submitted to suffer the discount ruling upon sterling exchange in New York. This discount he would be excused from suffering if a bill upon London entitled him to gold there which he could bring to New York.

Bank transportation and insurance charges have been running at rates to explain only about three points of the discount of sterling exchange. The actual discounts have, then, expressed the terms at which an English bill could be made to command gold in New York as the reflection of the terms at which the medium of payment in which the bill is paid in London can be exchanged for gold in London available for export to the New York market.

[2] "Since the 30th of June, 1915, the deposits of the joint stock banks of the United Kingdom, including the Bank of England, have increased from $4,055,000,000 to $5,220,000,000."—Theodore H. Price, before the Western Economic Association, Chicago, November 26, 1915.

[3] The December 1, 1915, report of the Bank of England shows an increase of circulation over December 3, 1913, of 27 million dollars.

Increase of public deposits	200 million
Increase of other deposits	268
Increase of government securities	90
Increase of other securities	340

These "other deposits" function in the main as reserves for city banks. In December, 1914, the Bank of England had increased its "other securities" by 426

Nothing, then, could have been more certain than that these methods of war finance must set in motion a prompt and extraordinary increase in general prices. In fact, the *Statist's* report for October, 1915, showed a rise in the English price index of a trifle over 34 per cent between June, 1914, and October, 1915.

Precisely what may have been the purpose of financial improvidences of this sort is not to be asserted with entire confidence. Probably it was to make borrowing easy and interest rates low, whereby government loans should be easily placed at a low interest-charge. Such, at all events, have been the results, only that still other results have also accrued—and especially untoward results. War financing through deposit-banking facilities is a colossal unwisdom.

If, however, these untoward results—shortly to be further indicated—shall appear to be as disastrous as the making of them was gratuitous, there are, in other directions, certain compensations. Never, henceforth—one dares to believe—will any economist attempt to explain interest rates as dependent either upon the supply of equipment goods—instrumental wealth, capital goods—or upon the flow of new savings into the capital market.[1] The financial experience of the past year, and the current phenomena of loan

millions over those of June, 1914. But easy credit and low interest rates have prompted the banks to carry much of this paper themselves. So, also, the proceeds of much of the acceptance paper which the Bank of England in the early weeks of the war discounted for the city banks it has borrowed back from the city banks, and has lent to the government.

[1] "Prior to the outbreak of the war, the following postulates of economic science were regarded as fundamental and immutable: (1) that an advance in interest rates must follow an increase in the demand for loans or credit; (2) that the value of investment securities would decline as interest rates advanced.

"It was generally expected that the expense of conducting the war would result in enormous borrowing by the belligerents and that the consequent scarcity of capital would severely depress the price of all investment securities. . . . .

What has happened? . . . .

"Since the outbreak of hostilities they have increased their national debts by an aggregate of about $17,252,000,000.

"Nevertheless, the open discount rate in London has not averaged over 3 per cent for the past eight months, and in New York last week six months' commercial paper sold at 2¾ per cent."—Theodore H. Price, in his address before the Western Economic Association, Chicago, November 26, 1915.

rates and of stock and bond quotations, should suffice to prove that the interest rates of any given time, the fluctuations of these rates in rise or fall, the ease of borrowing, the supply of available funds to seekers of capital, the terms of their loans and the rates of these loans, are all directly determined by the banking situation and the banking policies of the particular time. Banks supply funds, and supply them through creating them. And funds are what the business man borrows, as they are also what those governments now at grips of battle both need and seek. Practically there is nowhere any borrowing of anything else. Thus the world in general—inclusive of the economists—is witnessing an extraordinary expansion in the borrowing demand, at the same time with an attendant and unprecedented destruction of wealth and of capital goods, a destruction unparalleled both in speed and in volume. And yet, by the magic of banking, and precisely because the process is one exclusively within the field of banking and directed by the banks, rates of interest, instead of rising, have remained, and still remain, exceptionally low—all owing to the generous supply of what the financial world knows as capital and reckons and pays interest on. Never before has any scientific doctrine so rapidly passed through insolvency and into decreed bankruptcy. So rapid, indeed, have been the proceedings and the decree that most of the sponsors of the doctrine in question are not yet quite aware of what has occurred to them and to their categories. But here are the market quotations[1]—quotations for which the economists consistently with their previous views, can offer only one line of possible explanation—an increasing, rather than a diminishing, world-wealth, and expanding and generous, rather than acutely inadequate, supplies of equipment goods; or in default of this, an

[1] The *Journal of Commerce*, November 10, 1915, gave the following figures:

	Nov. 9, 1915	Last Year
Call money	$1\frac{3}{4}$	6
Time money, 90 days	$2\frac{3}{4}$	$5\frac{3}{4}$@6
Commercial paper, choice names	3@$3\frac{1}{4}$	$5\frac{1}{2}$@6
Reserve bank discount rate	4	....
New York banks surplus reserve	$189,100,000	$15,914,000
Average price of 20 railroad stocks	105.26	80.41
Average price of 12 industrial stocks	116.79	80.41

incredibly rapid increase in the supply of funds derivative from abstinence—an increase beyond any possible explanation or historical precedent. On any other terms the interest phenomena of the present period must appeal for explanation to forces outside the pale of the traditional analysis. Capital must forthwith take on the guise of a supply of suspended purchasing power, derived in the larger part from banking sources and made available through banking channels, rather than a stock of instrumental equipment or of raw material, or a fund of subsistence goods. By this method must the economists arrive at a concept of business loan capital which shall connote merely that sort of thing that business men lend and borrow upon terms of interest.

But to assert that, in the larger part, the bankers determine whether funds shall be plenty and cheap (interest low) or scarce and dear (interest high) is not to impute to them an altogether unlimited power. They may at times have to reckon with their reserves—to make their peace with them. It is, however, not the less clear that when redemption is suspended all limit upon inflation is removed. And redemption is suspended in England, as also in France, Germany, and Austria.

In some other respects also, the powers of banking fall short of omnipotence. Granted that the banks, by expanding their grants of credit accommodation, may modify the supplies of business capital, alter the volume of currency, and readjust the rates of interest, they are nevertheless unable therewith to maintain unchanged the general price situation. These inevitable limitations upon banking power are clearly manifest in England. The attempt to hold the rate of interest low has, on the whole, been surprisingly successful. An easy "money market" has greatly facilitated the placing of national securities both with private investors and with banking institutions. Thereby the government has not only secured control of a large part of the billion dollars of interest maturities in foreign securities, but it has made possible the retention by the English investor of most of his foreign investments. Exports of goods and exports of gold, and gains from transportation, together with interest claims abroad, and with some

small sales of foreign securities, have, up to this autumn, financed the enormous importations of supplies from abroad. But prices have, meanwhile, extraordinarily risen in England.[1] Thus becomes

[1] The rise of 35 per cent from the basis of June, 1914, as reported in November, has continued for the ensuing month, and is now, according to the *Statist* figures, 40 per cent.

"On many lines of men's worsteds and dress goods the prices now asked abroad are too high to attract many importers. At the moment, many of the mills in the English woolen districts are in need of work . . . . but the prices . . . . preclude the likelihood of large orders from this side until prices come down. . . . .

"For the next few months there does not seem to be any prospect of any material broadening in imports because of the range of prices prevailing abroad."—*Journal of Commerce*, November 10, 1915.

Much difference of opinion and of estimate exists both as to the volume of our securities held abroad and in England alone and as to the volume of securities already marketed in America. The English authorities have commonly asserted that English holdings of foreign investments approximate twenty billions of dollars, something like four billions of which are American securities.

"It was estimated last week that the United States has taken back from Europe approximately $1,550,000,000 of American securities since the outbreak of war, the amounts purchased from the several countries being about as follows:

Great Britain	$950,000,000
Germany	300,000,000
France	150,000,000
Holland	100,000,000
Switzerland and other countries	50,000,000
Total	$1,550,000,000

"As loans amounting to about $768,000,000 have been placed in this country by belligerents and neutrals since the outbreak of war, we have aided Europe to the extent of approximately $2,318,000,000 since the war commenced, and practically all of this total has been absorbed."—*Annalist*, December 20, 1915.

". . . . According to figures recently issued by the Chief of the Bureau of Foreign and Domestic Commerce, in Washington, it is estimated that the United States of America owes no less than $7,000,000,000, distributed among the great creditor nations as follows:

England	$4,000,000,000
Germany	1,250,000,000
France	1,000,000,000
Holland	650,000,000

". . . . Already, according to estimate, we have shipped about £150,000,000 to £200,000,000 of bonds, and as they mostly go straight into consumption there is no sign of the demand drying up. If all the American bonds held in this country are sent back to their place of origin, we shall probably ship from £350,000,000 to £550,000,000 more, and when that supply is exhausted there will remain the large volume of preference stocks held mainly by private investors and the credits hitherto maintained abroad by wealthy men anxious to avoid taxation by the British Government."—London correspondent of the *Journal of Commerce*, of date of December 8, 1915.

greater and greater the difficulty of marketing whatever products England has to spare, after account is taken of its restricted production and its increasing demands upon English industry for the support of the war. Nor are these all the evils that go with rising prices, from the point of view of financial endurance. England's purchases, both at home and abroad, are made on terms of higher prices, and thus with an increasingly rapid movement toward the exhaustion of her credit possibilities, and with a nearer approach to the utmost margin of credit flotation—financial exhaustion.

Nor, even, are these the most serious of the difficulties. The current methods of war finance are making impossible the national economies essential to a long test and trial of economic endurance, as distinguished from purely financial endurance. England's war activities, so far as they are not supported by domestic productive power, must derive their supplies from abroad. The extent to which this appeal must be made to foreign production is precisely the extent to which domestic production fails to supply a surplus product available for war purposes over and above the current consumption for ordinary purposes. Resort must therefore be increasingly had to external financing in the degree that domestic productive power is inadequate to the support of war activities. Consequently, the ultimate determinant of England's financial endurance is England's economic endurance, the balance of productive power and of product which she can devote to her military operations—men, food, clothing, ships, equipment, ammunition.

War financing, for a war of long duration, must, therefore, direct its efforts toward the most rigorous and heroic economy in the consumption of goods on the part of the civil population. Some loss of productive power is always inevitable when great masses of laborers must be shifted over out of their customary occupations in order to minister to the pressing necessities of war. But it is still worse if, together with the impaired efficiency of the civil population, there goes a rising level of consumption on its part. Higher wages may, it is true, be necessary to induce the change of occupations. But these higher wages must somehow be intercepted so as to prevent them from emerging in a higher level of

consumption of products. Taxation may help, and England has begun to impose it. Government borrowing from wage-earners might help, and England is just making a beginning in attempting it. But the net result, so far, is failure.[1] Wages are rising even faster than prices. Thus the laboring masses in England are receiving higher real wages than ever before—and are spending them. An extraordinary and imperative public need is being met by a greater prodigality in individual expenditure and consumption. Thus, English war finance sums up, in results if not in purpose, in an attempt to make good the subtraction of millions of men from industry and the enormous expense of their maintenance in military activities through an increasing per capita consumption of the people who stay at home.[2]

[1] "The British working classes . . . . are enjoying the unprecedented sensations of money to blow. . . . . The fact that only £5,000,000 was raised . . . . in the sale of 5*s*. vouchers . . . . was the first indication to the Government that they were not succeeding in tapping the huge resources which lie in the pockets of the wage-earners." —*Journal of Commerce*, December 8, 1915.

"The Government is concerned with the want of evidence that the industrial classes are saving any substantial proportion of their much enlarged earnings. . . . . A means must be found for preventing the wage-earners from dissipating their earnings in directions which, as a rule, are quite frivolous."—Correspondence of the *Annalist*.

"The government has failed completely to round up any considerable portion of the war-wages and war-bonuses. . . . . Reckless indulgence in all forms of luxury is seen everywhere."—*Commerce and Finance*, December 15, 1915.

"The poor man's treasury bill in £1 denominations seems to have proved an utter failure—even at 5 per cent.

"The *Statist's* index number of food prices has risen from 110.0 to 113.1 since October."—*Ibid*., December 15, 1915.

[2] "There has been a sharp upward movement in the rates of wages, and although the cost of living, taken in its widest sense, has risen very appreciably—to some extent due to the increased wages of labor—the margin of free income now possessed by the workers in trades and industries is exceptionally large.

"In its lower ranks Great Britain is not a thrifty nation, and fortuitous gains such as now come into possession are merely regarded as golden opportunity for indulging in luxuries.

"Doubtless it is in the power of the Government to compel economy by loading up taxation . . . . but compulsion in any obvious form is alien to the country's traditions."—London Correspondent, *Annalist* of December 20, 1915.

"The bulk of the money which is carrying on the war, and which finds its way down through the Government and contractors to the small merchants and workmen results in the enforcement of unusual economy upon the wealthy and the middle classes

On the whole, then, the surprise is that England has any surplus of domestic product or of productive power available for her military undertakings—that, having employed her extensive foreign revenues for the purchasing of supplies from abroad, she has not also to provide through some sort of government financiering nearer 5 billions than $2\frac{1}{2}$ billions of products from foreign sources of supply—practically all from America—and to create somehow in America the purchasing power with which to do it.

(except those concerned in war work, who are many), and encourages unusually free spending in the stratum usually most economical.

"Men from the agricultural districts who formerly earned four dollars a week are getting fifteen and twenty dollars from the Government, and men are being paid five dollars a day for putting up huts for the soldiers. Annan Bryce, brother of the former Ambassador to America, testified that boys who formerly worked for two dollars a week are being paid by the government more than ten dollars for carrying the bags of government carpenters.

"A writer in the *Daily Mail* says: I met a man who, without any previous experience as a craftsman, was earning from six to eight pounds a week [$30 to $40] making shell cases in a certain Government munitions factory. I am told that workmen in Birmingham now drive up to their daily task in taxicabs, and that in that fortunate city the shops are doing a trade in expensive luxuries such as has never been known before.

"Extravagant payments to contractors and to buyers and experts who have been taken into Government employ is a complaint against the Government levied by many business men. Corruption is not charged, but high and wasteful disbursements. . . . . The country would not suffer so much from these conditions if it was self-contained like Germany and money merely flowed in a circle from the Government into the hands of the people, and back to the Government in taxes and loans. But Britain is importing enormous quantities of goods . . . . besides war supplies."—London correspondent, *Journal of Commerce*, November 10, 1915.

"The office of Lord Chancellor alone, with almost nominal duties, is costing $125,000 a year. Lord Buckmaster, recently head of the Press Bureau, is drawing the salary of $50,000, while his predecessor, Lord Haldane, and two other former incumbents of the office, are receiving pensions of $25,000 each. The two law officers of the Crown, the Attorney-General and the Solicitor General, are compensated chiefly by fees which amount to about $100,000 for each official."—London correspondent, *ibid.*, November 10, 1915.

"American merchandise generally is very much more in evidence in London than it ever was before, it being a very common sight to see in the city truckloads full of huge American cases particularly underwear and hosiery."—Percy L. Guiterman, of Guiterman, Rosenfeld & Co., *ibid.*, December 10, 1915.

"The country is having about the best holiday trade that has been witnessed since 1906, and at some centres the volume is breaking all records. This recovery reflects the increased purchasing power of the people as indicated by the very much

It is at this point that America comes to be directly connected with the war finances of Europe and to be acutely interested in their methods. As in England, so in America, these methods have so far been mainly methods of credit expansion. It might, at first glance, seem that our sole protest against these methods should refer merely to the shortness of the period during which they can avail. Not only does England need to buy, but we are keen to sell. It is thus a matter of regret with us if England is progressively falling short in her ability to finance her importation of goods from us through her export of goods to us. If the war is to continue, we must supply an increasingly enormous balance. We are interested that methods be devised by which this shall be possible, else England must lack the supplies necessary to maintain her armies, and we must fail of a market for our goods. Some basis upon which England can buy here is therefore necessary as the sole basis on which we can sell. We cannot have gold. England has sent too much already—too much either for her good or for ours. The 300 millions of imported gold in our banks are, in truth, one part of our present problem.

Borrowing in America might solve the English problem, at the same time with solving our own. And it is to borrowing that England is now turning her attention as her method of getting goods through paying for them by issuing securities. Nor are there any essential difficulties in this solution of the problem, if only the borrowing is conformed to wise methods and is possible in consistency with these methods. But, in point of fact, the easy financial conditions maintained in England—as on the Continent in general—have had the effect of holding interest rates low in

better condition of wage-earners everywhere and the belief that even better times are ahead."—Knauth, Nachod & Kuhne, *ibid.*, December 10, 1915.

"The theatres are thronged. The picture palaces are packed. The country roads are covered with a procession of joy-riding motor-cars, often in charge of a chauffeur assisted by a footman. Many of the shops have had such a Christmas season as never before, and lurid stories are afloat of the diamond rings, furs, and pianos with which the workers are making the most of the first chance they have had of spending a surplus above the necessaries of life. Some few are economizing drastically, but they are nearly all folk whose income has been lessened or remained stationary."—*Daily Chronicle*, London, January 8, 1916.

America, albeit they are rising here, as there, for long-time securities.[1] The investing public will not lend—but only the banks. No sufficient inducement is offered, or can be offered, to the ultimate investor, unless the new bonds are issued at attractively high rates of return—and perhaps not even then.[2] The result is an actual and prospective inflation of deposit currency to the extent that the loans are not marketed with private investors.[3] These methods inevitably stimulate a rise of prices in America. The harm to the borrowing nations is evident in the unfavorable terms

[1] "Another indication that the Government is striving to delay a new long-term loan is the totally unexpected announcement tonight of an unlimited issue of 5 per cent five-year exchequer bonds at par.

"It is conceded that British credit at the moment is temporarily on at least a 5 per cent basis. Any new loan would necessarily have to recognize this situation and would for that reason prove highly expensive, since under the terms of the $4\frac{1}{2}$ per cent loan, instalments of which have recently been completed, any higher rate on future issues would automatically apply to the older issue."—Special cable to the *Journal of Commerce*, December 17, 1915.

Thus, the financial methods of England in the American money market parallel the English methods at home. If any considerable part of the first Anglo-French loan has found, or should later find, a market with private investors in America, it would be a matter of great surprise. Why the bankers, with their overflowing reserves, are freely lending on call at $2\frac{1}{2}$ per cent and on time at $2\frac{1}{4}$ per cent, and are yet selling securities that net them $5\frac{1}{2}$ to 6 per cent, is not readily clear. That in large measure they are doing this is not credible.

"Six months' loans were placed at $2\frac{3}{4}$ per cent last week—a low figure never touched before during the busy autumn season—coming at a time when the world-wide demand for capital exceeds all records."—*Commerce and Finance*, December 1, 1915.

[2] At the expiration of the sixty-day period of the syndicate subscribing for the 500 million of Anglo-French bonds, the rates at which securities must be marketed in England and France find a parallel here. The Anglo-French bonds are now selling at a rate to net the investor something over 6 per cent. But, even at this rate, the investing public does not readily absorb the bonds. The statement by the Morgan house that "over 60 per cent of the bonds purchased by the syndicate were taken for investment" should be interpreted in the light of the following comment of the *Journal of Commerce* of December 10: "Many of the banks and trust companies have subscribed to the bonds in large amounts and these institutions are expecting to hold them in their vaults as investments. They feel confident that before maturity the bonds will be selling at par, and in the meantime they are earning 5 per cent."

[3] "A plan is soon to be placed in operation by the British Treasury for the so-called mobilization of American stocks and bonds to be used as the basis of a new American credit. Holders of these securities are to be asked to make over their securities to the Government either in the form of sale or loan. But the chief endeavor will take the form of securing the loan of these securities to the Government, the latter paying an extra one-half per cent over the regular incomes of the bonds for the privilege."—*Journal of Commerce*, December 6, 1915.

"For the third loan, which will be conducted by the government, and is still in the incipient stages, American securities of unquestioned worth are being mobilized,

at which they must obtain their necessary supplies. The harm to the United States is of another sort, but equally clear. It makes inevitable a change in the value of our monetary unit, and a disturbance of all relations of deferred payment—a business boom, a stock boom, and even, *as actually*, a bond boom—all the evils and all the deferred disasters and readjustments that go with currency expansion, high prices, speculation, and ultimate reaction.

That all these evils are manifest in their beginnings it is not hard to show: Our per capita of money in circulation has increased from \$36.40 a year ago to \$38.04, as of December 1, of this year—an increase of 7.3 per cent. Our gold holdings are greater by 16.7 per cent. Bank clearings this month are running at 52 per cent greater than a year ago, and 30 per cent greater than for the corresponding period of 1913. The cost of living increased in the month preceding December 20, 1915, by 3.1 per cent.[1] The surplus reserves in the national banks of the country and in the reserve system are nearly a billion of dollars. Demand deposits in the national banks alone are 1,100 millions greater than in 1913.[2] The completed calendar year will show a favorable trade balance of approximately 2 billion dollars.[3] Interest rates still rule low on all short-time paper. Bonds are rising in price in the American markets while the volume of sales is approaching or passing the

the government engaging to borrow them from investors and offering a bonus of one-half of one per cent on their yield as an inducement."—*Commerce and Finance*, December 1, 1915.

"What course the market will take in the future must depend largely on the details of the Government scheme. . . . . It may take the shape of a loan of securities, with interest at ½ per cent above the rate paid on the bonds, the bonds themselves being handed over to the Government, which would transfer them. It is believed to be a scheme of national borrowing on the security of private property."—London correspondent, *Journal of Commerce*, December 8, 1915.

[1] *Annalist*, December 20, 1915.

[2] "The National City Bank . . . . deposits rose from 260 million on October 31, 1914, to 501 million on November 10, 1915, ... nearly 100 per cent. Shortly after, something like 70 million dollars of increase came from the proceeds of the Anglo-French loan. . . . . The Chase National Bank deposits rose from 126 million to 255 million in the one year. The National Bank of Commerce deposits rose from 134 million to 246 million. A half-dozen others could be named as having increased their deposits approximately 100 per cent. . . . . The phenomenon is taxing the capabilities of the bankers in regard to finding suitable and proper investments."—*Journal of Commerce*, December 7, 1915.

[3] *Annalist*, November 20, 1915.

record mark.[1] Interest rates for long-time loans, while appreciably hardening, are still surprisingly low.[2] There is a marked recovery in the volume of trade and in the prices and in the volume of traffic and earnings of the railroads. Even in Japan "apparently there is a boom on . . . . just as big, proportionately, as that in the United States."[3] So, likewise, in Canada.[4] Silver is rising relative to gold.[5]

[1] "The bond market is active at prices that are 4 per cent to 6 per cent above those ruling six months ago. Such cities as Kenosha, Wisconsin, for instance, have been able to sell their 4½ per cent bonds at a premium."—*Commerce and Finance*, December 1, 1915.

"A remarkable advance in the prices of bonds has occurred during the last two months. . . . . The average gained nearly three points in October, and nearly four points in two months. The advance has continued since November. In view of the unparalleled war demand for capital, this advance in the prices of our railroad bond is surprising."—Market letter, Warren W. Erwin & Co., November 12, 1915; see also the *Annalist* of November 29, 1915.

[2] "The 50 million dollar loan by the New York banks to the English banks was at 4½ per cent.

"A marked recovery in business from recent depression is beyond question. It has now been in progress for the past two months and shows every evidence of further continuance. Phenomenal bank clearings, abnormal expansion in loans, extraordinary gains in railroad traffic, intense activity in the steel industry, partial resumption of building operations, and a more active retail distribution are only a few of the many indications of real improvement.

"The chief sources of this revival have been in the harvest, the war, and a superabundance of funds. . . . . Cheap money and abundant credit are . . . . powerful stimulants.

"According to . . . . the Bureau of Railway Economics, the September operating income per mile was . . . . 19.6 per cent greater than in 1913. A comparison of September, 1915, with the average September of the preceding five years, shows an increase of 17.4 per cent."—*Journal of Commerce*, December 14, 1915.

[3] *Commerce and Finance*, December 1, 1915.

[4] "Plentiful bank funds, which were the vanguard of our prosperity, are now appearing to brighten the future for long-depressed Canada. The Bank of Montreal reports its assets of October 30 as $302,988,555, compared with $259,481,663 a year ago. Upon the opening of the subscription lists for the $50,000,000 war loan on November 22, $17,000,000 was paid up within an hour. The Greenshield's index number of Canadian business activity, based on bank clearings and gross railway earnings, reports the month of October, 1915, at 160.2 per cent, as against the five-year average, 1910–14, of 142.2 per cent." "For several months we have traced the course in the index as it gradually crept nearer and nearer to the five-year average. It has now, at a single bound, passed far above the five-year average. . . . . The volume of transactions in October in listed securities at Toronto and Montreal has not been equaled since 1912."—*Commerce and Finance*, December 3, 1915.

[5] "All forms of silver metal have shown an increased strength recently. . . . . Last Friday 56c an ounce, which is an advance of 1½c over Wednesday. There was a rise of 1¼c in Mexican silver dollars to 43c."—*Commerce and Finance*, December 1, 1915.

It is, however, the purpose of the present argument, not so much to show how far the stimulation through expanding currency has already gone, as to indicate the forces implicit in the situation. That which has already happened is significant merely as evidence of a process which is under way. Further citations or comment and authority should also be interpreted in this emphasis.[1]

[1] "It is well to take the measure of this expansion as it goes on, and to note how easily the volume of loans has been swollen by $1,000,000,000. The available credits and cash reserves of New York will continue to increase, and back of the whole situation is the Federal Reserve system, with its resources as yet practically unemployed."—*Bulletin of City National Banks*, December, 1915.

"The only thing of which plenty exists is money. . . . . Retailers are besieging manufacturers to deliver goods in quantities such as they cannot furnish, exactly as the railroads have been besieging the steel industry for equipment which neither the mills nor the car shops can turn out. . . . . From the extraordinary excess of demand over supply, it is evident that the soaring prices encountered on every hand are genuine. . . . . A credit expansion of over $5,000,000,000 is perfectly possible among the banks. . . . . High, and perhaps higher, prices will reign for some time to come. . . . .

"Dun's says: 'Each week domestic consumption enlarges.'

"Bradstreet's says: 'The circle of activity is widening, and is one in which producers' views as to prices dominate. . . . .'

"Merchandise is piling up at productive centers for distribution at a rate which far exceeds the railroad's capacity for handling it. They have not the equipment. . . . . Current earnings are breaking records. In the circumstances they could not do otherwise."—William C. Ward, *Commerce and Finance*, December 8, 1915.

"Merchants . . . . are covering their wants for at-once and spring delivery. . . . .

"Many carpet and rug . . . . mills are sold up, and are withdrawing their lines." —John V. Farwell Company, *Annalist*, December 13, 1915.

"Advances in prices of commodities have forced buyers out of their accustomed policy of anticipating only the known immediate needs, thus accelerating the congestion in both industry and transportation. Easy money is made easier by the excellence of collections. . . . .

"Chicago bankers' . . . . holdings of securities were recently $5,000,000 more than at the beginning of September, and nearly $9,000,000 more than a year ago. . . . .

"A steady broadening of the demand and increase in volume for municipals, public utilities, industrials, and rails. . . . . Supplies of old seasoned issues are low."—Special correspondence of the *Annalist*, Chicago, December 10, 1915.

"There is room for a much greater recovery. With six months commercial paper at $2\frac{3}{4}$ per cent—the lowest on record—and with something like $10,000,000,000 of unused banking credit—the greatest seen in the world's history—we look for still higher prices for bonds. . . . .

"All of our commercial and financial publications admit that a business boom is now on. In iron and steel and in many other lines conditions were never as prosperous as they are now. Between Pittsburgh and New York the railroads are congested with freight as never before. The building trades are gaining rapidly and even real

More difficult is it to surmise how far this process of inflation will have time to go—much depends upon the duration of the war—or to get a definite limit to the possibilities implicit in the actual situation here. This temptation to expansion meets us at a most inopportune time. The new reserve system, by setting free several hundred millions of reserves, gold and other, was certain to inaugurate a period of expanding deposit credit and of rising prices—subject, however, to inevitable limitations through the outflowing of our gold reserves to European markets. But the war, with the suspended redemptions in Europe and with the inflated paper-money prices in Europe, not merely dams up our gold at home but sends us more. Our surplus reserves are approximately 900 millions of dollars. Here alone is a margin of possible inflation of something like 8 billions of deposit currency. European borrowers—England

estate is becoming active and is picking up somewhat in eastern cities."—Market letter, Warren W. Erwin & Co., December 2, 1915.

"Every British mail steamer coming this way is bringing gold and securities in great volume, the latter apparently being immediately deposited with the banks as collateral for loans."—*Journal of Commerce*, December 6, 1915.

"The United States Steel Corporation yesterday reported that unfilled orders on its books, as of November 30 last, had increased 1,024,037 tons to 7,189,487 tons, as compared with the unfilled orders on October 31 last which aggregated 6,165,452 tons. These figures are indicative of the extraordinary conditions that are prevailing in the steel industry. . . . .

"One of the most remarkable increases in unfilled orders ever reported by the corporation."—*Journal of Commerce*, December 11, 1915.

"There is no longer complaint of deferred buying, but of difficulty in meeting the steadily expanding requirements. Consumptive demand exceeds supply in some lines. . . . .

"Development of Christmas business fulfils the most optimistic expectations . . . . both by the magnitude of the purchases and the preference shown for the more costly grades of merchandise. This condition is general. . . . . Wholesale prices are now at the highest level in half a century and the advance has been particularly striking in iron, and steel, where activity is unabated."—*Dun's Review*, December 11, 1915.

Warren W. Erwin & Co., in their November 12 Market Letter, report, among other indicia, the following "prosperity indicators": "marked advance in wages and employment with abnormally high wages for skilled mechanics; better demand for domestic dry goods than at any time since 1906–7; rising tide of traffic, increased demand for cars and ships, remarkable expansion in telephone and telegraph earnings; high and rising prices for commodities; enormous expansion in banking loans and deposits, made possible by 'the inflationary workings of Federal Reserve banking system' and by record imports of gold."

and the allies of England—are menacing an enormous solicitation of the banking accommodations made possible by these redundant reserves. And not merely this, the note-issue functions and the discounting functions of the new reserve system are equally available for additional expansion. The present gold holdings of the system ($482,800,000) would permit of rediscounts to an outside limit of over one billion of dollars. The deposit credits derivable from these would, in turn, furnish to the member banks reserves for an expansion of deposit credit to the extent of approximately 11 billions more. Bearing in mind that our present total of money and of demand deposits in circulation is something like $11\frac{1}{2}$ billions of dollars, we may make some vague estimate as to the general change in prices which would accompany the extreme of inflation possible in the present situation.

It must be taken as certain that, if the war is to continue, and for so long as it continues, the pressure for inflation in this country will be well-nigh irresistible, not only on the part of Europe to borrow, but on the part of our banking institutions to utilize their otherwise idle reserves. And with the derivative rise in prices of products the margins of gain in business must grow wider. Therewith must go, not only increasing demands for banking accommodations in the extension of business operations, but also higher prices upon corporate securities—through the increasing use of which as collateral further expansions of currency are inevitable. It is, therefore, a matter of extreme regret that, in conditions like these, the new reserve system, admirably adapted to furnish the element of elasticity in periods of financial strain and of contracting credit circulation, lacks all adjustments for stemming the tide of inflation when strong forces for inflation develop. Its present best service would lie in bringing about in some way a loan to England and France of these redundant supplies of gold, which, if employed as reserve material, must make inflation certain. Whether, then, one shall incline to deprecate the foregoing analysis as unduly pessimistic in tenor, or rather shall rejoice in its forecast of imminent business boom, is not greatly to the present purpose. The facts are evident enough, and the various interpretations of these facts sufficiently emphatic.

It is, indeed, quite beyond question that a business and speculative boom is in progress. No difference of opinion really exists as to this aspect of the case, but only as to the attitude to be taken toward the facts, and as to the policy to be adopted in view of them. For my own part, I hold the definite conviction that the methods of war finance which England is pursuing are equally disastrous for her own and for our interests. And not merely this: I hold even that, from the point of view of our long-time welfare, we should better forego the sale of goods to Europe than to sell these goods upon terms of so great disturbances to all relations of price and of deferred payment—so dangerous also to our financial and industrial future.

But there is, in fact, no need that these alternatives be presented. If England's purchasing ability in America is to be maintained, the first resource should be the sale of English securities in the American market. It would result merely that English bonds would replace American securities in the hands of the English investors, the credit in America obtained by the proceeds of the sales being placed at the disposal of the English government for use in its American purchases. On this basis small harm could result anywhere. American products would be favorably marketed, and England would purchase them at approximately normal prices. On this basis, also, England's power of financing abroad its military needs would last as long as its supplies of marketable securities should permit. It is true that this selling would probably depress the price of securities, even though the process were made as gradual as the necessities of the case would allow. But in some way—and in worse ways if not in this—the necessary purchasing power in America must be obtained. It is important that the foreign supplies be secured by methods which do not discourage frugality in England. England as an easy and profligate borrower is merely the other aspect of England as a careless and imprudent consumer. Domestic waste makes it only the more clear that England's ultimate victory must depend upon the wisdom of its financing, its economy in the employment of its credit resources. On any other basis England's financial exhaustion may easily antedate the economic exhaustion of Germany.

It must in fairness be said that England is slowly coming to some obscure recognition of the fact that whether, on the one hand, easy borrowing has been used as permission for generous wages and high consumption, or whether, on the other hand, the necessity of high wages has compelled the easy borrowing and has made possible the high consumption, it is in either case entirely certain that a standard of consumption high beyond precedent is not a practicable basis on which to support a colossal war.[1] It is true also that beginnings are being made toward increased consumption taxes—an excellent plan in mitigation of the evil of prodigally generous wages paid by the government, if at the same time no other remedy is possible. Attempt is also being made to intervene between the laborer's receipt of wages and his spending of them by persuading the wage-earners to invest in government bonds in denominations as small as £1. The net result so far is, as we have seen, practically failure. Success indeed might not be greater, even were it the financial policy of the government to make the rate of interest attractive. The English industrial system has scantily fostered the practice of thrift among the English masses. Hand-to-mouth habits of living do not lend themselves readily to the necessities of a policy of national parsimony.

Nor is it precisely true that England has entirely failed to recognize that in its holdings of international securities lies its chief fiscal reliance. But this recognition arrives regrettably late. Had it come earlier, England might have avoided its price inflation and its suspension of specie redemption. Banking would have been relied upon neither for the maintenance of low interest rates nor

[1] "Circumstances have caused the rate of wages in many directions to rise to an artificial level, and it is this situation which is causing the most serious anxiety. . . . .

"The greater part of the expenditure on the war is being provided from borrowings. Every rise in wages must increase the amount of those borrowings as the cost of the commodities required by the Government is bound to advance . . . . a vicious circle sending up prices in all directions, so that in the end the country might find its obligations beyond its capacity to bear, and more especially if those who benefit most from the heavy expenditure do not return a fair share of their income to the Government in the form of loans. . . . .

"It is to their own interest quite as much as to that of other sections of the community that the working classes should realize this simple economic fact and refrain from demanding any further increase of remuneration."—*Annalist*, December 27, 1915, special London correspondence.

for the absorption of public securities. Conditions would have been allowed to establish themselves in which the sale of foreign securities by the English holder could have appealed to his business interest. The funds so made available in America for governmental purposes would have been exchanged by the English investor for English war securities.

Nor even now have the directors of English policy rightly learned their lesson. They have it still in mind that the proper use of English holdings of securities is as collateral for banking accommodations in America.[1] If, as the 500 million loan in America indicated, the American public will not purchase English bonds at a rate of 5 per cent, there were doubtless good reasons for thinking that it would not purchase them at any rate within the realm of practical consideration. Thus, it was believed that the use of English securities must be the next resource. But how to make use of these securities? The accepted policy has been that they be used, not for sale, but for collateral.

[1] On the whole, also, American opinion regards favorably the current and the prospective methods:

"It is not difficult to see evidence of a connected, well-defined policy of handling the acute sterling exchange strain. The first link in the chain was the arrangement of the $500,000,000 Anglo-French loan, for which no security at all in the form of collateral was given. The next link was the $50,000,000 credit by American banks to English banks. For this British war bonds to the amount of £11,000,000 were deposited as collateral. Having obtained these large amounts on favorable terms, recourse is now, as a third link, to be made in sums as required for additional loans on the basis of the very best collateral that American banks and other lenders will ask."—*Journal of Commerce*, December 15, 1915.

"It is believed in financial circles that the Treasury expects to place an unlimited amount of the new bonds on sale. . . . . The reputation of Reginald McKenna, Chancellor of the Exchequer, has been enhanced by his plan to make use of American securities for borrowing purposes."—*Ibid.*, December 17, 1915.

"A novel experiment, but a very practical one."—*Annalist*, December 20, 1915.

There are, however, occasional voices of protest, of uneasiness, or of warning, both in England and America:

"Our supply of banking funds, however, has become so swollen by the unnatural, politically forced flow of gold from Europe to the United States that there is a possibility of unhealthy inflation of both speculation and trade."—*Annalist*, December 20, 1915.

"James B. Forgan says that the present movement in business will continue so long as European nations . . . . can settle for their purchases from us by shipping

Following close upon the half-billion dollar loan, the London banks arranged to borrow 50 million dollars from the New York banks on the security of 11 million dollars worth of bonds of securities deposited in trust with the Bank of England. The further step, now in contemplation, amounts essentially to the same thing. The government will hire of English investors their American securities —or, it may be, will exchange English bonds for them, and use these securities as collateral for further banking operations in America.

These methods, it is true, may easily attain their specific purpose, if only America through its banking interests is disposed to ratify this sort of financiering. That the result must be a constant rise in the system of prices at which the English must purchase need not, of itself, greatly perturb us, so long as it is satisfactory to the English and effective to furnish England with its necessary purchasing power in our markets. Nor is it directly a serious matter that we sell our goods at high prices so long as we can get gold promises for these goods and adequate collateral for the promises. But it is infinitely serious that all of our domestic business must share in the consequences of the rapid upward movement in prices that must attend these methods of war finance. To some of us, also, it is serious that this is for England a policy of incredible hazard, and most unfavorable to her ultimate fortunes in war. It is not only a policy which is most expensive while it endures, but one little likely to endure for that long period of war which English

gold, returning our securities to us, or by arranging deposit credit with us. Large surplus reserves are making further large expansions of business and of banking credits both possible and probable. My fear is . . . . a violent reaction when the war is over."—*Journal of Commerce*, December 6, 1915.

"It must be the aim and the duty of the Federal Reserve banks to counteract violent fluctuations of interest rates and to keep them as closely as possible to normal; they must freely use their lending power when rates rise beyond fair and healthy levels, but withdraw their funds and arrest, if they can, a movement which would lead to excessively low rates such as would be apt to bring about a dangerous reaction."—*Ibid.*, December 11, 1915.

"The amount of gold in the United States is now so colossal that the additional importations may lead to wild speculation, and it is undesirable in everyone's interest that a still greater amount of gold should accumulate in the United States."—Sir George Paish in interview already cited; see also J. A. Hobson, in the *XIX Century*, September, 1915.

authority has, from the beginning, foretold. And not merely is it a policy in which we can co-operate only at a constantly increasing harm to ourselves, but it is at the same time a policy which must at some point reach its limit—a limit on the further side of which is the probability of a great disaster. Nor, indeed, are we safe in assuming that the reaction will be postponed until the point has been reached at which our credit system is bearing its utmost possible strain. Any reversal of England's financial policy—e.g., a belated attempt to sell its securities under pressure in America—may precipitate a sharp reaction in our credit and financial markets.

I hold then that the present situation is acutely menacing. I do not, however, believe that it has in it no possibility of remedy or of palliation. But certain it is that neither is in immediate or hopeful prospect. Primarily the dangers are those of England's financial policy. England may change this policy—as must be the devout hope of those of us who believe that only with the triumph of the English cause is there the hope for us of escape from the nightmare of militarism or the promise of worth and endurance in western civilization.

Not so encouraging, however, in default of an English change of financing policy, is the prospect of adequate measures to be taken in America. I have already noted that our banking system affords the necessary unity of action by which to provide against the dangers of contracting credit. But the system is still separatist and chaotic for all purposes of resistance to expansion. With the

With the proofs of this article in my hands, I clip the following: "WASHINGTON, Jan. 21.—A committee of the American Bankers' Association has proposed the retirement of the existing 347 million dollars of United States demand notes commonly called greenbacks. The proposal is to pay out the 150 million gold reserve held against these notes and exchange the remaining 197 million for United States Bonds.

"The object of the proposal is to set at work a process that will offset the expansion of the currency.

"The total amount of money in circulation and in the banks January 1 was 364 million more than a year ago. All the increase and more was gold or its equivelant.

"More than 200 million of federal reserve notes have been put in circulation but all except a few million merely displace gold and does not represent inflation of currency. Some bankers, however, fear that ultimately the federal reserve notes will furnish a dangerous inflation."

generously abounding reserves of the thousands of competing banks, it is not easily credible that any large number of them will refuse to expand their operations in face of the practical certainty that other banks will so expand, and solely through the conviction that it were better that none of them should. It is, indeed, possible that a vigorous and definite campaign of resistance on the part of two great financial powers in the country—the Morgan and the Rockefeller groups, with their affiliated banking and insurance interests—might avail, by force of dictation and by leading of influence, to achieve the necessary unity of banking policy. In fact, however, both of these groups appear to be fully committed to the opposite emphasis—one of them, indeed, the well-authenticated agent of English financial policy in America. And yet it is true that all financial institutions—businesses whose net assets are money or the right to money—stand especially to lose by the present policy of currency expansion and of the depreciation of the standard. Only with savings banks and insurance companies are the losses likely to be greater than with the commercial banks.

The adoption of better methods is, however, simple enough, if only the disposition exist. The issues of war securities could well be handled through a great guaranty association of adequate paid-up capital and with still larger contingent and secondary liabilities. Under the guaranty of this association, for which the payment could be generous, the bonds of England and her allies would find an unlimited market in America, and find this market under conditions involving no serious dangers of currency inflation.

H. J. DAVENPORT

UNIVERSITY OF MISSOURI